

Renaissance Capital's Global IPO Review: 1st Quarter 2009

March 31, 2009

IPO activity remained extremely low, but we still may see further strong returns

- Global IPO activity remained extremely low, with one US deal and one Hong Kong deal
- 29 companies have filed up-to-date prospectuses, indicating an interest in moving forward with IPOs
- History still suggests that high-quality companies at discounted valuations may lead to strong returns

So far, things have played out as we predicted in our report ["When Will The IPO Market Return?"](#) back in October: ongoing market volatility has led to a near-frozen IPO market, but the deals that get done tend to perform strongly thanks to solid fundamentals and discounted valuations. There are 29 companies that have filed up-to-date US prospectuses and we think there are many others intending to list in either the US or international markets waiting in the wings. While issuance will likely remain low in the near future, we believe that several of these prospective IPOs will be able to raise capital and generate significant returns for investors.

Although Mead Johnson was the only US IPO out of four attempts, the stock performed well

IPO issuance remained extremely low in the first quarter. In the US, it was the second consecutive quarter with only one IPO, and there was also only one non-US deal, down from five in the fourth quarter. The lone US IPO was pediatric nutrition company Mead Johnson (MJN), a large, highly profitable company with a leading brand in a defensive industry that was priced at a discount to its peer group on both earnings and cash flow. History has shown that slow IPO periods can lead to strong returns, thanks to higher-quality companies being priced at more attractive valuations, and we have seen Mead Johnson's stock trade up 20% since its February debut.

In contrast to Mead Johnson, three other companies tried to go public in the US and failed for various reasons. O'Gara Group (OGAR), a security/defense company, was unprofitable, newly integrated and had seen falling sales in some of its segments in its most recent financials. Madison Square Capital (MDQ) was a newly formed REIT that had no track record, and investors were skeptical of its ability to achieve and maintain strong returns. Lastly, biodiesel producer Changing World Technologies (CWL) was tiny, unprofitable, had not yet demonstrated the viability of its business model and was on the verge of bankruptcy.

Global issuance fell to two, down from six in the fourth quarter

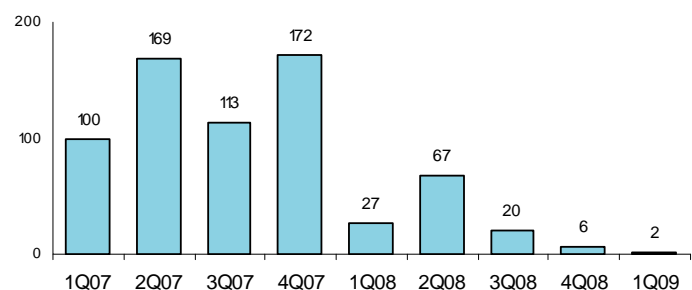
While the first quarter generally sees seasonally weak global IPO issuance, the two deals so far this year represent a 93% drop from the 1Q08 level of 27 and a step down from the six IPOs in 4Q08. Proceeds fell almost 50% q/q and were down 98% from a year ago. Besides Mead Johnson, the only other IPO was China's Real Gold Mining

(246.HK), which dropped rapidly in the days following its IPO, trading down as much as 28% because of a falling Hang Seng Index before rebounding in recent weeks (it is now 1% below the issue price). While there have been some signs of life in international markets, such as upcoming April offerings by mobile network Vodafone Qatar in Doha and Chinese liquor/cigarette distributor Silver Base in Hong Kong, we believe that, as in the US, companies that are adequately capitalized for the near future are generally choosing to wait rather than attempt offerings under difficult conditions. Although the broader market rebounded in March, stabilization will be key to any pick-up in IPO issuance.

Global Proceeds (US\$ bil)



of Deals



The US pipeline contains 29 companies with updated prospectuses that may attempt IPOs in the near future

The next IPO on the US calendar, Chinese game developer Changyou.com (CYOU), offers strong revenue growth, extremely high margins and a recurring revenue model, which may help it join Mead Johnson in the winners' circle. It remains to be seen whether investors will be turned off by its reliance on a single game, but with the deal being pitched at 6.5x earnings, the price may be enticing enough to outweigh the risks. Reports are that the underwriters are closing the order book early ahead of the expected April 1st pricing, which bodes well for the deal and other IPOs that may follow suit in the near future. As a further positive indicator, the [Renaissance IPO Index](#) is up 1.8% year-to-date, well ahead of the 12-13% drops by the Dow and S&P 500, showing improved perception of recent IPOs in the last few months.

Looking beyond the immediate future, we examined the US pipeline in order to get a sense of how many companies are still actively considering IPOs. A stream of withdrawals over the past year has whittled the US pipeline down to 142 companies, but only 84 operating companies (excluding the 58 SPACs). Of these companies, 29 have reported financial results for the period ended 9/30 or 12/31, and we view this shortlist as the most likely source of IPO activity over the next few months. The 29 companies are listed on the last page of this report.

Encouragingly, the median most-recent-quarter (MRQ) growth of the active pipeline is 31%, meaning that there are still numerous growth companies looking to tap the IPO markets. Also, in contrast to recent years, only four of these 29 companies were unprofitable in their most recent quarter, corroborating our thesis that higher-quality issuers emerge during periods of low activity. While earnings are being pressured at many of them (10 of the 29 suffered narrowing

operating margins in their last quarter), which may be a result of economic conditions or company-specific reasons, they are mostly showing an ability to keep their earnings positive and thus weather the recession. Because of these favorable growth and profitability metrics, we believe at least a few of these will be able to pull off successful IPOs in the near future as long as their stocks are priced attractively.

Notable Pipeline Constituents

File Date	Company	Ticker	Business	LTM sales	MRQ growth
3/17/09	Changyou.com	CYOU	A leading online game developer and operator in China.	\$202	144%
Education					
12/22/08	Bridgepoint Education	BPI	Provides online postsecondary education programs.	\$218	122%
9/23/08	Rosetta Stone	RST	Provides technology-based language learning solutions.	\$209	54%
12/21/07	Education Management	EDMC	Provides campus-based and online post-secondary education programs.	\$1,834	19%
Software					
1/26/09	Medidata	MDSO	Provides an on-demand technology platform for managing clinical trial data.	\$118	31%
3/21/08	SolarWinds	SWI	A leading provider of enterprise-class network management software.	\$93	32%
1/11/08	LogMeIn	LOGM	Provides on-demand remote connectivity solutions to enterprises/consumers.	\$52	86%
\$1 billion+ Revenue					
11/12/08	Alon Brands	ABO	Operates 306 7-Eleven stores and markets the FINA brand of motor-fuels.	\$1,363	3%
9/24/08	Edgen Murray Limited	EMY	A distributor of specialty steel products to energy infrastructure markets.	\$1,162	33%
7/25/08	Select Medical Holdings	SLC	A leading operator of specialty hospitals and outpatient rehabilitation clinics.	\$2,124	4%
7/17/08	Brand Energy	BEI	Provides maintenance/capital services to the energy infrastructure market.	\$1,618	12%

Several segment trends stand out in the active pipeline and are displayed in the table above. The last IPO of 2008 was online university Grand Canyon Education (LOPE), and three education-related stocks appear keen to follow in its footsteps, taking advantage of LOPE's strong performance (up 44% since its IPO) and the defensive nature of the industry. Two other postsecondary education providers, Warburg Pincus-owned Bridgepoint Education (BPI) and Goldman Sachs/Providence Equity-backed Education Management (EDMC), are also in the pipeline. Bridgepoint has rapidly grown its revenue from \$29 million in 2006 to \$218 million in 2008 and generated \$55 million in free cash flow last year, while Education Management has \$1.8 billion in revenue but is slower-growing and has weaker cash flow dynamics, partly due to its higher debt burden. Language-learning software provider Rosetta Stone (RST) is growing at a 52% clip and offers a high gross margin play on the education sector with strong brand recognition (there are rumors that it will be one of the next companies to brave the IPO waters). Although many education stocks have pulled back recently following several months of outperformance, the sector is likely to remain attractive to IPO investors.

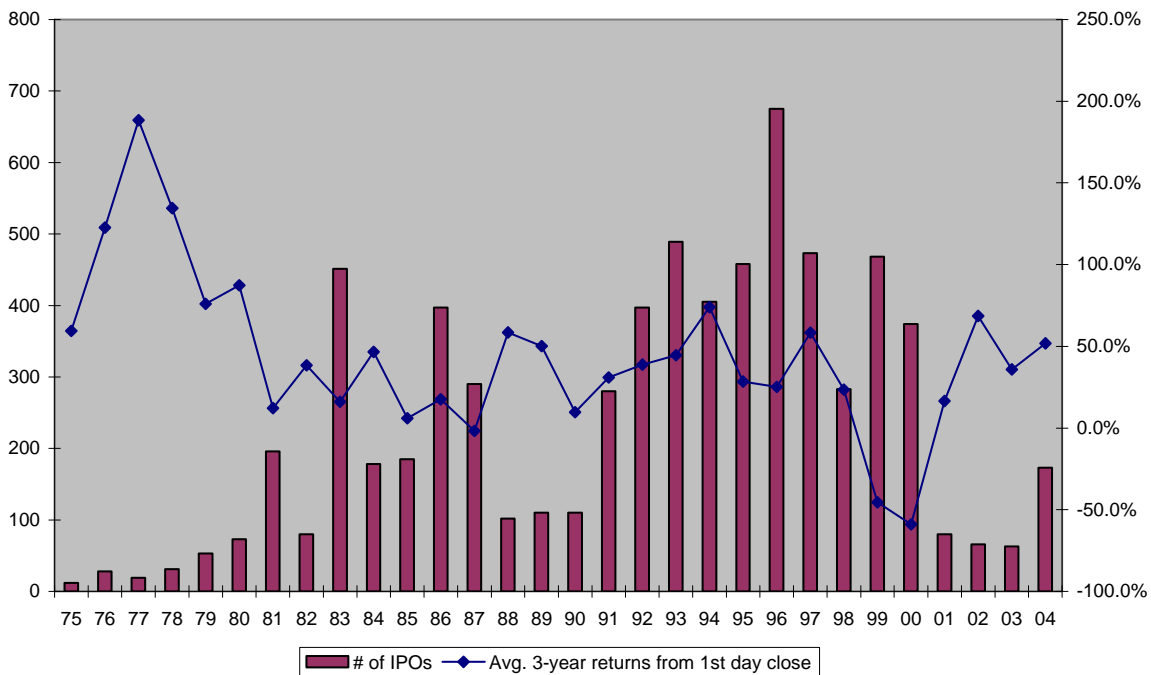
While tech IPOs have been virtually nonexistent since 2007, several enterprise software companies hope to buck that trend, and their recurring revenue models and high gross margins may help them succeed. Medidata (MDSO), which provides clinical trial management software to the healthcare sector, and SolarWinds (SWI), which provides enterprise-

class network management software, both grew over 30% in the 4Q08 and are now at a \$100 million+ revenue run rate, while remote-connectivity solution provider LogMeIn (LOGM) is smaller (\$52 million in 2008 sales) but growing at 86%. In contrast to 2007, when software company SuccessFactors (SFSF) could go public with marketing expenses exceeding revenue, all three of these companies generated GAAP operating profits in their latest quarter. As tech companies make up three of the four year-to-date filings, we are likely to soon get some indications of IPO investors' appetite for the sector.

Higher-quality IPOs at attractive valuations should produce strong returns even if issuance remains low

Our study of the recession of the 1970s showed that issuance remained slow until an extended period of strong IPO returns coaxed investors back into the new issues market, as evidenced by the chart below. Between 1976 and 1980, the average IPO gained 27% annually in its first three years of trading (measured from the first-day close). We continue to expect this pattern of above-average returns in a slow issuance period to hold true today. With the last two US IPOs generating strong returns, we believe this pattern is playing out and that issuance will start to pick up later this year as investor confidence gradually returns.

US IPOs outperform in slow issuance periods



Source: Renaissance Capital and Jay Ritter, University of Florida

"Active" IPO Pipeline

File Date	Company	Ticker	Industry	LTM sales (mm)	MRQ growth	MRQ operating margin
3/17/09	Changyou.com	CYOU	Technology	\$201.8	144%	58.0%
2/20/09	Government Properties Income Trust	GOV	Financial	\$75.4	5%	42.0%
1/30/09	OpenTable	TABL	Technology	\$55.8	23%	2.5%
1/26/09	Medidata	MDSO	Technology	\$118.4	31%	4.8%
12/23/08	FriendFinder Networks	FFN	Technology	\$265.3	-8%	7.2%
12/22/08	Bridgepoint Education	BPI	Business Services	\$218.3	122%	10.3%
11/12/08	Alon Brands	ABO	Consumer	\$1,362.5	3%	0.1%
11/10/08	Compressco Partners, L.P.	GSJK	Energy	\$68.9	10%	29.6%
9/24/08	Edgen Murray Limited	EMY	Materials	\$1,161.8	33%	15.0%
9/23/08	Rosetta Stone	RST	Technology	\$209.4	54%	13.8%
8/22/08	O'Gara Group	OGAR	Business Services	\$36.0	-8%	-13.6%
8/15/08	CWCapital Realty Trust	CWR	Financial	n/a	n/a	n/a
8/12/08	Verisk Analytics	VRSK	Business Services	\$864.6	12%	34.6%
8/8/08	A123 Systems	AONE	Energy	\$58.2	165%	-80.5%
7/31/08	STR Holdings	PVS	Energy	\$266.0	57%	26.1%
7/25/08	Select Medical Holdings	SLC	Health Care	\$2,124.2	4%	7.0%
7/25/08	AutoGenomics	AGMX	Health Care	\$4.2	166%	-266.2%
7/17/08	Brand Energy	BEI	Energy	\$1,617.6	12%	9.4%
6/16/08	Invesco Agency Securities	IVR	Financial	n/a	n/a	n/a
6/5/08	NextG Networks	NXTG	Technology	\$19.7	55%	-31.5%
4/25/08	Madison Square Capital	MDQ	Financial	n/a	n/a	n/a
4/14/08	DigitalGlobe	DGI	Technology	\$275.2	42%	31.7%
3/21/08	SolarWinds	SWI	Technology	\$93.1	32%	45.3%
1/11/08	LogMeIn	LOGM	Technology	\$51.7	86%	7.7%
12/21/07	Education Management	EDMC	Business Services	\$1,834.0	19%	14.6%
12/19/07	Prometheus Laboratories	RXDX	Health Care	\$278.1	31%	12.0%
7/13/07	Abraxas Energy Partners, L.P.	AXLP	Energy	\$83.4	101%	45.7%
5/1/07	Cumberland Pharmaceuticals	CPIX	Health Care	\$35.1	32%	15.3%
4/19/07	Cypress Sharpridge Investments	CYS	Financial	\$23.7	-8%	n/a

BEI sales are pro forma. MRQ data for FFN/OGAR/NXTG based on 9 mos ended 9/30. MRQ data for EDMC/AXLP/CYS based on 6 mos ended 12/31.

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